# NOTES

## WASHINGTON NOTES

### THE WAR FINANCE CORPORATION

The final approval by the President of the so-called War Finance Corporation Act on April 9 lays the foundation for a new system of government financial activity additional to the broad service performed by the Treasury Department through its fiscal functions and by the Federal Reserve Board and Reserve banks. Few changes of far-reaching importance were introduced into the act during the later legislative history, the chief alterations being found in the amount of obligations it may issue (now limited to six times its capital stock or $3,000,000,000 in all) and in the conditions under which it, or holders of its obligations, may obtain rediscounts from Federal Reserve banks. On the latter point some important protective provisions have been introduced, it being specified that there shall be a discriminating differential rate of 1 per cent against such rediscounts, while the power at first conferred upon Federal Reserve banks to trade unreservedly in the obligations of the new corporation in the open market is withdrawn. Both these latter changes and particularly the last named—the withdrawal of the open-market power—must be esteemed, however, of very considerable significance. Rediscounted paper protected by the obligations of the corporation will now bear the indorsement of a member bank; and the possible purchase that might have been made direct from individuals will thus not be a possible factor of danger.

The new act thus safeguarded contains possibilities of great help to industry and much less probability of abuse than in its earliest form. What is now awaited with utmost interest is its eventual application and the type of organization developed for the new concern. This may or may not prove similar to the commercial banking corporation, but must in some particulars at least resemble it in general features. Of fundamental importance, too, will be the question how and in what ways the new enterprise will adjust itself to the Federal Reserve System and how far it will be necessary to give it the aid of the older organization. Much in all these matters will depend upon the position of affairs at the

close of the third great government loan now in process of sale and the condition in which the banks generally and the savings banks in particular are left by that operation.

### THE THIRD LIBERTY LOAN ACT

The Third Liberty Bond Act approved by the President on April 4 not only greatly enlarges the power of the government to borrow by the issue of both long-term bonds (limit now $14,000,000,000 in lieu of all other outstanding but unused authorizations) and certificates of indebtedness ($8,000,000,000 in lieu of all previous authorizations), but it also changes in certain essential respects both the scope and the technique of public borrowing. By advancing the rate of interest carried by the short-term Treasury certificates to 4½ per cent the foundation was laid for a further and parallel increase in the rate borne by the long-term bonds. The fact that their yield has been set by the new act at only 4¼ per cent gave rise to some surprise and criticism in financial circles, while apprehension regarding the possible subscriptions was aroused by the first two issues (convertible into the new 4¼ per cent bonds). This apprehension has been somewhat allayed by the success of the loan organization in selling the new issue of $3,000,000,000 of 4¼ per cent bonds announced almost simultaneously with the presentation of the new act, but the situation has none the less been somewhat anomalous. The advance to 4¼ per cent amounted to a recognition of the fact that the government must meet changing commercial conditions as to rates of interest, but it also indicated a disinclination to go the full distance indicated by these conditions as necessary.

Meantime the banks of the country have themselves felt the upward movement of "money rates," and it has required the full influence of the Federal Reserve System to prevent these rates from being forced up to unprecedented levels. Such increases, if allowed to occur, would of course have rendered the position of the government as a borrower much more difficult, since it would almost have compelled further additions to the rates borne by bonds in order to keep control of the fluid funds for which various groups of banks are disposed to bid so actively.

From the point of view of technique two features of the act are worthy of special note: the provision establishing a fund equal to 5 per cent of the outstanding bonds for use in purchasing such bonds (the purpose being to maintain quotations at or near par), and the provision authorizing the issue of some of the new bonds (in an amount to be determined by the Secretary of the Treasury) payable in foreign currency at

the normal par of exchange. This latter provision, it is hoped, may serve to provide a means of partly "stabilizing" the dollar in foreign countries where the variations of exchange have of late beaten it down to points considerably below par. Precisely what degree of success can be realized in the use of either of these financial innovations remains to be seen, and will depend in no small measure upon the way in which they are employed. Both will afford opportunity for attempting extremely significant and interesting experiments not previously tried in our government financing.

### SILVER FOR EXPORT

The President on April 23 signed the so-called "Pittman Silver Bill" which has been more or less carefully considered for some months past, and thereby has put into operation what is possibly the most important silver legislation enacted during the past twenty-five years.

By the terms of this bill the Secretary of the Treasury is authorized to break up silver dollars now held behind $350,000,000 of outstanding silver certificates, convert such dollars into bullion, and thereby render available a corresponding quantity of fine silver which he is thereupon authorized to dispose of at a price not less than one dollar per ounce. Simultaneously with the sale of any such silver the Secretary is expected to enter into contracts for the repurchase of an equivalent amount of silver at the same rate—one dollar per fine ounce.

Eventually, therefore, if the plan works out, the government will have been provided with the same amount of silver that it has disposed of, and the purpose of the operation will have been merely that of providing an immediate large supply of silver far in excess of any that could have been commercially obtained had purchases depended exclusively upon the amount originally produced and brought to market. In order to provide for any shortage of currency that may be supposed to occur as a result of the withdrawal of this great volume of silver certificates, many of them in the one- and two-dollar denomination, provision is made for the issuance of Federal Reserve bank notes based upon certificates of indebtedness, and one-year Treasury notes, both of which are vested with the circulating privilege, thereby providing a new source of currency supply. These notes will of course be direct obligations of the Federal Reserve banks and as such would have to be redeemed in gold out of the reserves of that metal held by the Federal Reserve banks. It is supposed, however, that the bulk of the new issues made in the smaller denominations of one, two, and five dollars will be but seldom presented

for redemption save in so far as they might have to be replaced by new currency in substitution for worn and dirty notes.

The possibility of difficulty in the situation lies of course in the chance that the Secretary of the Treasury may not get back the same amount of silver that he sells, and so may not be able to retire the new Federal Reserve bank notes and restore the silver certificates to their former position. Should he not do so there would be a loss to the government of about 22 cents on each dollar sold, the bullion value of the silver dollar being a little below 78 cents when silver is $1.00 per fine ounce. On $350,000,000 this loss would amount, therefore, to something like $77,000,000. As the silver now held by the government was originally bought at about $1.01 per ounce there is no material loss in the actual sale, and the loss indicated at the rate of 22 cents per dollar is the loss corresponding to a so-called "profit" formerly made by "coining the seigniorage," i.e., issuing the dollar at a face value higher than its bullion content. It might be said that it is desirable to dispose of the silver holdings of the government and that no opportunity more favorable than the present has been offered for a good while. The new plan, however, provides, as already seen, for repurchasing the silver, so that even with full success there will be no advantage from the standpoint of our silver holdings. In the meantime there is a return to a partially abandoned method of issuing bank notes secured by government obligations.